90-630

No. .....

Supreme Court, U.S.
FILED
OCT 15 1990
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

STATE OF NEVADA EMPLOYEES' ASSOC., INC.,
(SNEA), a Nevada Corporation, et al.,
Plaintiffs/Appellees,

v.

WILBUR K. KEATING, Executive Officer of the
Public Employees' Retirement System, et al.,
Defendants/Appellants.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIAN McKAY, ESQ.
Attorney General of
the State of Nevada

SCOTT W. DOYLE, ESQ.
DANA K. SAMMONS, ESQ.*
Deputy Attorneys General
(Counsel of Record)

Heroes Memorial Building
Capitol Complex
Carson City, Nevada 89710
Telephone: (702) 687-4170

Counsel for Petitioners
*Attorney of Record

QUESTIONS PRESENTED

I. Does the Contract Clause (article 1, section 10 of the United States Constitution) protect precontractual expectancies of future public employees from reasonable modification by a state?

II. Can a state "tier" its public employees' retirement system without impairing the constitutionally protected contractual expectancy of newly hired and future public employees?

III. Is a "strict vesting" theory required by article I, section 10 of the United States Constitution when dealing with public pension plan rights as opposed to a "reasonable modification" approach in order to satisfy the "reasonable and necessary" test?

LIST OF PARTIES

The following persons and entities were parties to the proceedings in the Court of Appeals for the Ninth Circuit; the petitioners in this Court are italicized, all others are respondents:

NO. 88-15514

Plaintiffs-Appellants: State of Nevada Employees' Association, Inc. (SNEA), a Nevada corporation, as representative of its members; Ellen Steiner, Sue Palczewski, Harry Dudley, Russell Benzler, Darrell Reed, Reemey Brown, Joe Riolo and David Drew, as members of SNEA, and on behalf of themselves and all other present and former state employee members of SNEA similarly situated.

Defendants-Appellees: *Wilbur K. Keating, Executive Officer of the Public Employees' Retirement System; Tom Weisner, Chairman, Peggy Glover, Vice Chairman, Wilson McGowan, Joyce Woodhouse, Clair*

Haycock, Julius Conigliaro, Karen Brewster, members of the Public Employees' Retirement Board; George Murphy, Director of the Department of Personnel; Darryl Daines, State Controller of the State of Nevada, Patricia Cafferatta, State Treasurer of the State of Nevada; and Does I through XX, all being sued in their official and individual capacities.

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Contract clause protection has never been extended to this degree by any federal court in the nation.

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No. ____

IN THE

Supreme Court of the United States

WILBUR K. KEATING, Executive Officer of the Public Employees' Retirement System, et al.,

Petitioners,

vs.

STATE OF NEVADA Employees' ASSOC., INC., (SNEA), a Nevada Corporation, as representative of its members; ELLEN STEINER, et al.,

Respondents,

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

The petitioners respectfully petition this Court to issue a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in *State of Nevada Employ-*

ees' Association, Inc. (SNEA), a Nevada corporation, as representative of its members; Ellen Steiner, et al., vs. Wilbur K. Keating, Executive Officer of the Public Employees' Retirement System, et al. No. 88-15514 on May 18, 1990. The judgment reversed the United States District Court for the Northern District of Nevada, and determined the 1983 amendments to the Public Employees' Retirement System Act (chapter 286 of the Nevada Revised Statutes), imposing a mandatory employer paid contribution system, were unconstitutional under article 1 Section 10 of the United States Constitution.

OPINIONS AND JUDGMENTS BELOW

The decision of the Ninth Circuit panel of May 18, 1990, is reported at 903 F.2d 1223 (1990). The opinion is reprinted in the appendix at page B-1.

The decision of the district court of September 21, 1988, is not reported, but is reprinted in the appendix at page C-1.

JURISDICTION

The judgment to be reviewed was entered on May 18, 1990. A petition for rehearing the judgment was filed on June 5, 1990. The Ninth Circuit order denying the petition for rehearing was filed July 17, 1990, and received by the state of Nevada on July 19, 1990.

The Court has jurisdiction to review the judgment pursuant to 28 U.S.C. § 1254.

CONSTITUTIONAL PROVISION AND STATUTE INVOLVED

Article 1, section 10 of the United States Constitution provides in part:

> No state shall . . . pass any . . . law impairing the obligation of contracts . . . .

The statute under review in this case, Nev. Rev. Stat. § 286.421, states in total:

1. Beginning July 1, 1985, a participating public employer shall pay on behalf of an employee the contributions required by subsection 1 of 286.410 if:

(a) The employee is hired after July 1, 1985; or

(b) The employee has 10 or more years of accredited contributing service. The employer shall begin paying an employee's portion of contribution on the date the employee attains 10 years of accredited contributing service, if this occurs after July 1, 1985.

2. Except for persons chosen by election or appointment to serve in elective offices of a political subdivision or as district judges of this state, payment of the employee's portion of the contributions pursuant to subsection 1 must be:

(a) Made in lieu of equivalent basic salary increases or cost-of-living increases, or both; or

(b) Counterbalanced by equivalent reductions in employees' salaries.

3. Except in the case of the elective officers described in subsection 2, the average compensation from which the amount of benefits payable pursuant to this chapter is determined must be increased with respect to each month beginning after June 30, 1975, by 50 percent of the contribution made by the public employer, and must not be less than it would have been if contributions had been made by the

member and the public employer separately. In the case of the elective county officers described in subsection 2, any contribution made by the public employer on their behalf does not affect their compensation but is an added special payment.

4. Employee contributions made by a public employer must be deposited in either the public employees' retirement fund or the police and firemen's retirement fund as is appropriate. These contributions must not be credited to the individual account of the member and may not be withdrawn by the member upon his termination.

5. The membership of an employee who became a member on or after July 1, 1975, and all contributions on whose behalf were made by his public employer must not be canceled upon the termination of his service.

6. If an employer is paying the basic contribution on behalf of an employee the total contribution rate is, in lieu of the amounts specified in subsection 1 of NRS 286.410 and NRS 286.450:

(a) For all employees except police and firemen, 15 percent of compensation; and

(b) For police officers and firemen, 18 percent of compensation, plus in each case any increase required by NRS 286.465.

A public employer which is paying the basic contribution on behalf of its employees shall, to the extent that the respec-

tive percentage rates of the contribution are increased above the rates set forth in this section on May 19, 1975, require each employee to pay one-half of the amount of the increase as provided in subsection 2.
7. For the purposes of adjusting salary increases and cost-of-living increases or of salary reduction, the total contribution must be equally divided between employer and employee.
8. Public employers other than the State of Nevada shall pay the entire employee contribution for those employees who contribute to the police and firemen's retirement fund on and after July 1, 1981, and may before that date pay all or part of this contribution. The State of Nevada shall pay the entire contribution on or after July 1, 1983, for:
(a) Members of the Nevada highway patrol; and
(b) Firemen in the division of forestry of the state department of conservation and natural resources, who contribute to the police and firemen's retirement fund.

STATEMENT OF THE CASE

FACTS

The respondents filed this matter on March 18, 1986, challenging the Nevada legislature's enactment of chapter 599 of

the 1983 session laws, which amended certain funding provisions of the Nevada Public Employees' Retirement System. Specifically, respondent challenged the conversion of current employees from a joint employee-employer contribution funding mechanism to a mandatory employer paid plan of contribution.

During the 1983 legislative session, the Nevada legislature enacted a series of amendments to chapter 286 of the Nevada Revised Statutes. The amendments provided for conversion of state employee members of the police/fire retirement fund from a joint employee-employer contribution system to an employer paid plan of contribution. This conversion was effective July 1, 1983. Local government members of the police/fire retirement fund had been mandatorily converted from the joint employee-employer contribution system to the

employer-paid plan of contribution effective July 1, 1981.

The 1983 amendment also required regular members of the retirement system already in the employ of a public employer to convert upon vesting (10 years service). New hires, after the effective date of the amendment (July 1, 1985) would automatically be placed in the employer pay plan of contribution.

Respondents challenged the mandatory nature of this enactment citing article I, section 10 of the United States Constitution as a bar to the contractual modifications set forth above.

At the time of the enactment of the employer pay plan of contribution, the Nevada legislature also enacted a system of actuarially funded post retirement benefit increases, Nev. Rev. Stat. § 286.5756; a contribution rate increase, Nev. Rev. Stat. § 286.465; and a "fail-

safe" provision prohibiting post retirement increases should contribution rates not increase adequately to pay for them, Nev. Rev. Stat. § 286.516. The amortization period for unfunded liability was also restarted for a new 40-year period, in 1984. The purpose for the above-described amendments was to finance post-retirement benefit increases. The mandatory conversion of state employee members of the police/fire retirement fund from a joint employee-employer contribution plan to the employer-paid plan of contribution was done for the purpose of making these members eligible for the more generous spouse-option benefit codified in Nev. Rev. Stat. § 286.667, as well as to finance post-retirement benefit increases.

PROCEEDINGS BELOW

This litigation began in the district court as an action for injunctive, declaratory and incidental relief arising under article I, section 10 of the United States Constitution; the Due Process Clause and the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution; title 42, United States Code, Section 1983; article 15, section 15 of the Nevada Constitution requiring a merit system of employment in the executive branch of state government and Nevada Revised Statutes section 284.175 and related statutes requiring a uniform pay plan.

After a three-day bench trial, the district court concluded that the plaintiff's primary argument was that the mandatory conversion from the joint contribution system to the employer-paid system of contributions for the Nevada Public Employees' Retirement Fund unconstitution-

ally impaired the obligation of contract. The court also determined that there was a subordinate claim by plaintiff's that the state had established two pay scales for the same work in violation of the state's merit system and the requirement of a uniform pay plan. App. C-21.

The district court rejected the subordinate claim based on the state merit system because it rested on a difficult interpretation of state statutes for which the Supreme Court of the State of Nevada had given no guidance. The district court determined that this was an inappropriate claim for consideration within its pendent jurisdiction. App. C-32

The first issue of constitutional import addressed by the district court was whether the Supreme Court of the State of Nevada's characterization of the conditions or circumstances authorizing modification of a public employees' retirement

system comports with the Contract Clause (article I, section 10) of the United States Constitution. App. C-24. The district court synthesized the test enunciated in *United States Trust Co. of New York v. New Jersey*, 431 U.S. 1 (1977) in the following terms:

> A public employment contract maybe modified by the State legislature if the modification is reasonable and necessary to serve a public purpose taking into consideration changed circumstances, whether comparable benefits are provided for benefits repealed, the weight and significance of the contractual impairment, the existence of a purpose to benefit the employees, and the availability of a reasonable alternative course. Deference should be given to the legislative judgment.

App. C-27.

The district court determined that the reasonable modification rule established by the Supreme Court of the State of Nevada in *Public Employee's Retirement Board v. Washoe County*, 96 Nev. 718, 615 P.2d 972 (1980) was reasonably consistent

with the requirements articulated in *United States Trust Co. v. New Jersey*.

The district court then concluded that the 1983 amendments did not unconstitutionally impair an employee's contractual rights to retirement benefits stating:

> The public purpose of the legislation is laudable, that is, to establish a system of regular post-retirement benefit increases to meet increases in the cost of living. After thorough study, adjustments were made to accomplish this which resulted in higher take-home pay for the employee and an actuarially sound retirement system. The only disadvantage was the elimination of the privilege of an employee to recover a portion of the money contributed to the State retirement fund in the event the employment terminated prior to vesting. The money of which an employee was thus deprived was not his money. Opinions of the Attorney General of the State of Nevada No. 307, September 6, 1957. It was money belonging to the State of Nevada under the terms of the employment contract with the public employee. *Atkinson v. Whittler*, 647 P.2d 72 (Wyo. 1982). Thus, although under the joint contribution system early termination included a contractual benefit of partial reimburse-

> ment, the elimination of that benefit has less significant impact than if a due process violation were also present. The contract impairment is less extensive. For the legislature to accomplish its purposes of funding post-retirement increases without increasing the cost of the retirement system, the elimination of the reimbursement feature was reasonably necessary. The legislative history and actuarial studies in evidence establish that it was thus made to appear to the legislature. No reasonable alternative resulting in less impairment was suggested. The State acted expressly for the benefit of the employees (not the case in *Trust Co., supra*). It also should be emphasized that at the time of the 1983 amendments almost two-thirds of the numbers [sic] of the state retirement system were already under the employer-paid method of contribution. The impact of the amendments on the whole body of covered employees was less significant. The Court should defer to the legislative judgment.

App C-29.

The United States Court of Appeals for the Ninth Circuit reversed the district court's determination that the elimination of the right of non-vested public

employees to withdraw pension plan contributions did not violate the Contract Clause. App. B-26.

The opinion of the United States Court of Appeals for the Ninth Circuit does not differentiate between the constitutionally protected contractual expectancies of then current public employees and those public employees who have been or will be hired after July 1, 1985. The opinion also does not explain the level of judicial scrutiny employed in examination of the reasonableness and necessity contained in the 1983 legislative amendments made to the Retirement Act.

REASONS FOR GRANTING THE WRIT

I. WHETHER A PREEMPLOYMENT CONTRACTUAL EXPECTATION IS PROTECTED BY THE CONTRACTS CLAUSE OF THE UNITED STATES CONSTITUTION, IS AN IMPORTANT QUESTION OF FEDERAL LAW WHICH SHOULD BE SETTLED BY THIS COURT.

A very important prerequisite to the applicability of the Contract Clause to an asserted impairment of a contract by state

legislative action is that the challenged law operate with retrospective, not prospective effect, *Maryland State Teachers Assoc., Inc. v. Harry Hughes*, 594 F. Supp. 1353 D. Md. (1984). This statutory retroactivity requirement is explicitly stated in *U.S. Trust Co. of New York v. New Jersey*, 431 U.S. at 18:

> Note 15:
> The holders of those bonds were not parties to the 1962 covenant, since the States undoubtedly had the power to repeal the covenant prospectively. See *Ogden v. Saunders*, 12 Wheat, 213, 6 L. Ed. 606 (1927).

The Ninth Circuit has ignored this necessary predicate by failing to isolate the retrospective provisions of Nev. Rev. Stat. § 286.421 from the prospective enrollment of all new hires into a fully employer paid pension system as of the appropriate effective date for the two trust funds. In declaring unconstitutional the provisions of Nev. Rev. Stat. § 286.421 applicable to new hires, the

Ninth Circuit has departed from the test used in determining whether there has been an impairment of a contract in violation of the Contract Clause. The threshold inquiry is "whether the state law has, in fact, operated as a substantial impairment of a contractual relationship [Emphasis added]." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244, (1978), quoted in *Energy Reserves Group, Inc. v. Kansas Light and Power Co.*, 459 U.S. 400, 401 (1983). The Ninth Circuit has created a contractual interest for individuals who are strangers to the contractual relationship under scrutiny in this matter. Members of the police/fire retirement fund hired after July 1, 1983 (the effective date of the conversion to the employer paid system), have no legitimate contractual right to a joint contribution pension system. Their contract for employment, the terms of which they accept by the

acceptance of employment, carries with it an employer paid pension plan. This holds true for newly hired employees in the regular pension fund, hired after July 1, 1985. The nature of the interests of these individuals do not rise to the level of contractual expectations protected by the prohibition of the Contract Clause. These interests are vastly different from those afforded Contract Clause protection in *U.S. Trust Co.*, where the security provided to bondholders when they purchased their bonds years before was "outright repeal[ed]." *United States Trust Co.*, 431 U.S. at 19. Persons already holding bonds had no way to protect the benefit of their bargain which had accrued when they bought their bonds.

The same analysis holds true in *Spannaus* where employees' prior employment time was required to be treated as if their pension rights had vested and the

employer, Allied Structural Steel Co., had to make retroactive payments to the pension fund, 438 U.S. at 246-47. The employer had no way to protect the benefit of its bargain with its employees that benefits for prior employment time would vest only if the employees remained employed until age sixty-five.

The legitimate expectations of the plaintiffs representing new hires do not include an immutable, unalterable pension plan as to <u>future</u> benefits to be earned pro rata by future employment service. *Maryland State Teacher Ass'n v. Hughes*, 594 F. Supp. at 1364. Future public employees do not have a vested right in any particular pension plan. An employee acquires a limited vested right to participation in a pension plan only upon acceptance of employment. *S.F. Firefighter v. City and County of S.F.*, 152 Cal. App. 3d 119 (1984). The Ninth Circuit expands the

concept of a limited vested or vested right to preemployment expectations. This is contrary to the jurisprudence of this court and expands the applicability of the Contract Clause prohibition far beyond any analysis of that clause which has been made to date. The Ninth Circuit's specific expansion of the Contract Clause to preemployment contractual expectations makes this case the appropriate vehicle for limiting Contract Clause applicability only to legitimate contractual expectations.

II. THE NINTH CIRCUIT HAS EFFECTIVELY CONVERTED THE STATE OF NEVADA TO A STRICT VESTING STATE, IN CONFLICT WITH THE JURISPRUDENCE OF THE NEVADA SUPREME COURT.

The decision of the Ninth Circuit effectively converts the jurisprudence of the State of Nevada regarding public pension rights from a limited vesting theory to a strict vesting theory.

> The limited vested theory is premised on the principle that a pension is an element of

> compensation and thus part of the employment contract [citation omitted.] A pension right may not be destroyed without impairing the contractual obligation of the public employer. However, prior to absolute vesting, pension rights are subject to reasonable modification in order to keep the system flexible to meet changing conditions and to maintain the actuarial soundness of the system [citation omitted.]

Public Emp. Ret. v. Washoe Co., 96 Nev. at 721, 615 P.2d 972 (1980).

The extension of Contract Clause protection to pre-contractual expectations contained within the Ninth Circuit opinion prohibits Nevada from ever changing pension benefits prospectively whether or not those benefits have vested in any manner. The Ninth Circuit, by failing to distinguish between the various plaintiffs in this matter, has put its decision in conflict with *Public Emp. Ret. v. Washoe Co.*, which determined that amendments to the Retirement Act could operate prospective-

ly, to employees hired after the effective date of the amendments.

> After a hearing, the district judge rendered a declaratory judgment in favor of respondents. He concluded that the 1977 amendments could operate only prospectively, to those employees hired after the effective date of the amendments. We affirm [emphasis added]. 96 Nev. at 721, 625 P.2d at 974.

While the Ninth Circuit acknowledges the existence of this case, and even quotes the operative language from *PERS v. Washoe County*, the court ignores the effect this language has regarding the nature of the right protected in a limited vesting jurisdiction. "By rendering services and making contributions, an employee acquires a limited vesting right to pension benefits which may not be eliminated or substantially changed by unilateral action of the governmental employer to the detriment of the member [emphasis added]." 96 Nev. at 721, 625 P.2d at 974. The quoted language, by description, ap-

plies only to those individuals rendering services to a public employer, not to those individuals who have no relationship with a public employer at the time of the legislative adoption of the amendments converting the system to fully employer paid plan of contribution, in a prospective manner. The Ninth Circuit stated:

> Undoubtedly, the amendments impair contractual obligations by terminating the state's obligation to allow public employees to withdraw pension contributions without penalty.

App. B-19.

The court failed to distinguish the prospective enrollment of new hires from those whose contracts were impaired and subject to the tests set forth in both *Trust* and *Public Emp. Ret.*

Further, the Ninth Circuit misstated the law of the case in *Public Emp. Ret. v. Washoe Co.* where the court invalidated retrospective application of an amendment to the retirement act which postponed

retirement for public employees under the Contract Clause because the detriment was not offset by a .5 percent reduction in the contribution rate. The Supreme Court of Nevada approved prospective application of this amendment to new hires. 96 Nev. at 723, 615 P.2d at 975.

Conclusion

For the reasons discussed above, the State respectfully requests that this Court grant certiorari and reverse the judgment of the Ninth Circuit Court of Appeals.

Respectfully submitted,

BRIAN McKAY
Attorney General of
the State of Nevada

SCOTT DOYLE
Chief Deputy Attorney
General

DANA K. SAMMONS*
Deputy Attorney General
Heroes Memorial Building
Capitol Complex
Carson City, NV 89710
702/687-4170
Counsel for Petitioner
*Attorney of Record

APPENDICES

APPENDIX A
NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

STATE OF NEVADA EMPLOYEES ASSOC., INC., (SNEA), a Nevada corporation, as representative of its members; ELLEN STEINER; SUE PALCZEWSKI HARRY DUDLEY, RUSSELL BENZLER, DARRELL REED, REEMEY BROWN, JOE RIOLO and DAVID DREW, as members of SNEA and on behalf of themselves and all other present and former state employee members of SNEA similarly situated,	)	C.A. No. 88-15514 D.C. No. CV-86-138 BRT
Plaintiffs-Appellants,	)	
v.	)	ORDER
WILBUR K. KEATING, Executive Officer of the Public Employees Retirement System; TOM WIESNER, Chairman, PEGGY GLOVER, Vice-Chairman, WILSON McGOWAN, JOYCE WOODHOUSE, CLAIR HAYCOCK, JULIUS CONIGLIARO; KARON BREWSTER, members of the Public Employees Retirement Board; GEORGE MURPHY, Director of the Dept. of Personnel; DARRELL DAINES, State Controller of the State of Nevada; PATRICIA CAFFERATA, State Treasurer of the State of Nevada; and DOES I through XX, all being sued in their official and individual capacities,	)	
Defendants-Appellees.	)	

Before: REINHARDT, BEEZER and KOZINSKI, Circuit Judges

Appellees' petition for rehearing is DENIED.

APPENDIX B

FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

STATE OF NEVADA EMPLOYEES ASSOC., INC., (SNEA), a Nevada corporation, as representative of its members; ELLEN STEINER; SUE PALCZEWSKI, HARRY DUDLEY, RUSSELL BENZLER, DARRELL REED, REEMEY BROWN, JOE RIOLO and DAVID DREW, as members of SNEA and on behalf of themselves and all other present and former state employee members of SNEA similarly situated,	)	
Plaintiffs-Appellants,	)	
v.	)	No. 88-15514
WILBUR K. KEATING, Executive Officer of the Public Employees Retirement System; TOM WIESNER, Chairman, PEGGY GLOVER, Vice-Chairman, WILSON McGOWAN, JOYCE WOODHOUSE, CLAIR HAYCOCK, JULIUS CONIGLIARO; KARON BREWSTER, members of the Public Employees Retirement Board; GEORGE MURPHY, Director of the Dept. of Personnel; DARRELL DAINES, State Controller of the State of Nevada; PATRICIA CAFFERATA, State Treasurer of the State of Nevada; and DOES I through XX, all being sued in their official and individual capacities,	)	D.C. No. CV-86-138-BRT OPINION

Defendants-Appellees.)
)

Appeal from the United States District Court
for the District of Nevada

Bruce R. Thompson, District Judge, Presiding

Argued and Submitted
December 14, 1989--Pasadena, California

Filed May 18, 1990
Before Stephen Reinhardt, Robert R. Beezer and Alex Kozinski, Circuit Judges

Opinion by Judge Beezer

SUMMARY

Constitutional Law

Affirming in part and reversing in part a judgment of the district court, the court of appeals held that elimination of the right of Nevada non-vested public employees to withdraw pension plan contributions violates the contract clause of the Constitution.

From its inception, Nevada's state employees' pension plan permitted joint contributions by employers and employees,

and employees could withdraw their contribution at any time without penalty. In 1983, the Nevada legislature decided to increase pension benefits to retired employees, and to defray the costs, made employer-paid plans mandatory for all state employees, eliminating the employee's right to withdraw pension funds without penalty prior to vesting. Appellant State of Nevada Employees Association, Inc. and individual employees filed an action challenging the 1983 amendments eliminating the right to withdraw pension contributions without penalty. The district court held that the 1983 amendments did not unconstitutionally impair the State's contractual obligations and declined to exercise pendent jurisdiction to decide the state law claims. SNEA appealed.

[1] Under *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977), [2] which

the State of Nevada agreed was controlling, it must be determined whether the pension statutes created contractual obligations, whether the amendments substantially impaired the State's contractual obligations and whether the impairment was reasonable and necessary to serve an important public purpose. [3] The State did not argue that the statutes providing pensions for public employees did not create contractual obligations, and [4] undoubtedly the amendments impair these obligations by terminating the State's obligation to allow public employees to withdraw pension contributions without penalty. However, the Nevada Supreme Court has explained that public employees' contractual pension rights are subject to reasonable modification, [5] but any disadvantage to employees must be accompanied by a comparable new advantage. [6] The State contended that with mandatory employer-paid

contributions, public employees would take home more money and retired employees receive a higher pension benefit. However, the rights of 93 percent of public employees will not vest [7] and the loss of the right to withdraw pension contributions cannot be offset by the increase in post-retirement benefits.

[8] The court found that the changes in Nevada's employees' pension scheme were not necessary to finance an increase in post-retirement benefits. There were alternative means available. [9] The State did not meet its burden of proving that the impairment of the public employees' pension rights was necessary to achieve an important public purpose.

COUNSEL

Norah Ann McCoy, Carson City, Nevada, for the plaintiffs-appellants.

Scott W. Doyle, Deputy Attorney General, Carson City, Nevada, for the defendants-appellees.

OPINION

BEEZER, Circuit Judge:

The State of Nevada Employees Association ("SNEA") and individual employees[1] argue on appeal that Nevada's termination of the right of public employees to withdraw their pension contributions without penalty constituted an unconstitutional impairment of contractual obligations and violated state law. The district court, after a three-day bench trial, decided (1) that plaintiffs' claims were barred by res judicata, (2) that Nevada's alterations to the public employees' pension plan did not unconstitutionally impair the State's contractual obligations, and (3) that the court would not exercise its discretionary

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[1]SNEA and the individual employees will be collectively referred to as "plaintiffs."

jurisdiction over the pendent state claims because state law was not settled. We reverse in part and affirm in part.

I

From its inception, Nevada's state employees' pension plan permitted joint contributions by employers and employees. Nev. Rev. Stat. §§ 286.410, 286.450. Employees could withdraw their contribution at any time without penalty. Nev. Rev. Stat. § 286.410(4). In 1975, the Nevada legislature introduced an alternative pension system that permitted public employers to pay the entire contribution, but did not allow employees to withdraw pension funds without penalty prior to vesting. Nev. Rev. Stat. § 286.421.

In 1983, the Nevada legislature decided to increase pension benefits paid to employees who had retired. Nev. Rev. Stat. § 286.5756. To defray the costs of the post-retirement benefits increase, the

legislature made employer-paid plans mandatory for all police officers and firefighters as of July 1, 1983, and for all other state employees effective July 1, 1985. Nev. Rev. Stat. § 286.421.

In 1983, SNEA along with individual police officers and firefighters challenged the State's application of the mandatory employer-paid pension plan. *State v. State of Nevada Employees Association*, 102 Nev. 287, 720 P.2d 697 (1986). Pursuant to the statute, the employers had reduced the employees' gross wages to offset the costs of the employer-paid contributions. The plaintiffs alleged that the state employers deducted more from their wages than was permitted under Nev. Rev. Stat. § 286.421. The Supreme Court of Nevada agreed. 102 Nev. 287, 720 P.2d 697.

SNEA and individual employees filed this action in 1984 challenging Nevada's

1983 amendments eliminating the right of all public employees to withdraw their pension contributions without penalty. After a trial, the district court held sua sponte that plaintiffs' claims were precluded. It additionally held that the 1983 amendments did not unconstitutionally impair the State's contractual obligations, and it declined to exercise its discretionary pendent jurisdiction to decide the state law claims. Plaintiffs appeal.

II

The district court on its own motion decided that plaintiffs' claims in this case are precluded by *State v. State of Nevada Employees Association*, 102 Nev. 287, 720 P.2d 697. Plaintiffs argue that the district court should not have raised res judicata sua sponte and that res judicata does not apply to this case. We review district court claim preclusion

determinations de novo. *Harbeson v. Park Davis, Inc.*, 746 F.2d 517, 520 (9th Cir. 1984).

Plaintiffs maintain that the State had the burden of raising res judicata as an affirmative defense. See Fed. R. Civ. P. 8(c). They contend that the State waived res judicata by failing to raise the issue, and they contend that the district court should not have raised res judicata sua sponte. There is merit to their position.

Res judicata must generally be affirmatively pleaded or waived. However, in *McClain v. Apodaca*, 793 F.2d 1031, 1032-1033 (9th Cir.1986), we held that it was appropriate for a bankruptcy court to raise res judicata sua sponte when it allowed the parties to submit post-trial briefs on the issue. In this case, the district court did not allow the parties to submit post-trial briefs on res

judicata. Because the trial court did not subject its res judicata decision to the rigors of the adversarial process, we set aside that court's conclusions that res judicata bars plaintiffs' claims.[2]

III

We review the district court's findings of fact for clear error on the contract clause claim, and we review mixed questions of law and fact de novo. *Wood v. Sunn*, 865 F.2d 982, 986 (9th Cir. 1988).

A

[1] The contract clause provides that "No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ." U.S. Const., art. I, § 10, cl. 1. The Supreme Court invalidated a state law under the contract clause for the

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[2]In any event, we note that most of the plaintiffs in this case are not police officers or firefighters and are not similarly situated to the plaintiffs in the earlier action.

New Jersey, 431 U.S. 1 (1977). The Court in *Trust Co.* declared a New Jersey statute unconstitutional because it impaired the state's contractual obligations to bondholders of The Port Authority of New York and New Jersey.

The Supreme Court explained that "the [contract clause's] prohibition is not an absolute one and is not to be read with literal exactness like a mathematical formula." *Id.* at 21, *quoting, Home Building Loan Association v. Blaisdell*, 290 U.S. 398, 428 (1934). To comply with the contract clause, impairments of state contractual obligations must be "reasonable and necessary to serve an important public purpose." 431 U.S. at 25.

One year after *Trust Co.*, the Supreme Court extended the *Trust Co.* holding to private contracts. In *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978) the Court struck down a Minnesota statute

which required private employers to pay a pension funding charge if they terminated a pension plan or closed an office in Minnesota when the funds in the pension plan were insufficient to cover full pensions for all employees who had worked at least ten years. The Court explained that the statute unconstitutionally modified the payment obligations of employers.

The Court retreated from its holding in *Spannaus* in *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400 (1983) and *Exxon Corp. v. Eagerton*, 462 U.S. 176 (1983). See G. Gunther, *Constitutional Law* 498 (1985). In these cases, the Court indicated a renewed willingness to defer to the decisions of state legislatures regarding the impairment of private contracts. G. Gunther, *Constitutional Law* at 498. However, because *Energy Reserves Group* and *Exxon* did not involve impairments of public contracts, they have

no direct effect on the Supreme Court's holding in *Trust Co.*

The Supreme Court has not examined the constitutionality of a state law which impairs a public contract since *Trust Co.* The Court's decisions in *Energy Reserves Group* and *Exxon* do not indicate that the Court would defer to state legislatures when public as opposed to private contracts are at issue. As the Court explained in *Trust Co.*, "complete deference to a legislative assessment of reasonableness and necessity is not appropriate because the State's self-interest is at stake." *Id.* at 26.

B

[2] The State of Nevada conceded at oral argument that *Trust Co.* controls the outcome of this case. Accordingly, we must determine (1) whether Nevada's public employee pension statutes create contractual obligations, (2) whether the 1983

amendments to the legislation substantially impaired the State's contractual obligations, and (3) whether the impairment was reasonable and necessary to serve an important public purpose.

1

[3] The State does not argue that Nevada's statutes providing pensions for public employees do not create contractual obligations. Nevada's Supreme Court has held that the State's public employees' retirement system creates contractual rights for non-vested employees. *Public Employees' Retirement Board v. Washoe County*, 96 Nev. 718, 615 P.2d 972, 974 (1980). Other courts consider pension rights of non-vested employees to be non-contractual gratuities. See, e.g., *Creps v. Board of Firemen's Relief & Retirement Fund Trustees*, 456 S.W.2d 434 (Tex. Civ. App. 1970).

Federal law, not Nevada law, controls whether the state statutes at issue create contractual rights protected by the contract clause. See *Continental Illinois National Bank and Trust Co. of Chicago v. State of Washington*, 696 F.2d 692, 698 (9th Cir.), *appeal dismissed for lack of jurisdiction sub nom. The Don't Bankrupt Washington Committee v. Continental Illinois National Bank and Trust Co. of Chicago*, 460 U.S. 1077 (1983); *Pineman v. Oechslin*, 637 F.2d 601, 604 (2d Cir. 1981). However, we agree with the Nevada Supreme Court that "the modern and better-reasoned view" recognizes that non-vested employees have contractual rights in pension plans "subject to reasonable modification in order to keep the system flexible to meet changing conditions, and to

maintain the actuarial soundness of the system." 615 P.2d 974-5.[3]

2

[4] The district court did not explicitly analyze whether the 1983 amendments substantially impaired the State's contractual obligations. Undoubtedly, the amendments impair contractual obligations by terminating the State's obligation to allow public employees to withdraw pension contributions without penalty. However, the Nevada Supreme Court has explained that public employees' contractual pension rights are subject to reasonable modification. *Public Employees' Retirement Board*,

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[3]The Nevada Supreme Court explained that "employees accept their positions, perform their duties, and contribute to the retirement fund in reliance upon the governmental employer's promise to pay retirement benefits . . . . By rendering services and making contributions, an employee acquires a limited vested right to pension benefits which may not be eliminated or substantially changed by unilateral action of the governmental employer to the detriment of the member." 625 P.2d at 974.

the pension plan, then they would not create a substantial impairment of contractual obligations.

[5] "To be sustained as reasonable, the modification must bear some material relationship to the purpose of the pension system and its successful operation; and any disadvantage to employees must be accompanied by comparable new advantages." *Id.* (citations omitted). In *Public Employees' Retirement Board* Nevada's Supreme Court invalidated a law which postponed retirement for public employees under the contract clause because the detriment was not offset by a .5% reduction in the contribution rate.

[6] In this case, the State contends that with mandatory employer-paid contributions, public employees take home more money and retired employees receive a higher pension benefit. As to the State's first contention, plaintiffs counter that

the State's analysis assumes that all public employees will work long enough to have their pension rights vest. Plaintiffs note that the rights of 93% of public employees will not vest. The higher take-home pay will therefore not offset the loss of the right to a refund of employee-paid contributions for the vast majority of employees.

[7] Moreover, the loss of the right to withdraw pension contributions cannot be offset by the increase in post-retirement benefits. The State cannot justify impairing its contractual obligations to public employees by pointing to advantages accrued by former employees. See *Abbott v. City of Los Angeles*, 50 Cal. 2d 438, 453, 326 P.2d 484, 492 (1958). The elimination of the right of public employees to withdraw pension contributions without penalty, like the law postponing retirement in *Public Employees' Retirement*

Board, substantially impaired the State's contractual obligations.

3

States may substantially impair their contractual obligations when the impairment is "reasonable and necessary to serve an important public purpose." *Trust Co.*, 431 U.S. at 25. The legislature adopted mandatory employer-paid contributions as part of its plan to finance an increase in post-retirement benefits. The trial judge found, and plaintiffs concede, that increasing post-retirement benefits is an important public purpose. We must decide whether the contractual impairment was reasonable and necessary.

[8] We believe that the changes in Nevada's public employees' pension scheme were not necessary. The district court found that "No reasonable alternative resulting in less impairment [than the implementation of mandatory employer-paid

sulting in less impairment [than the implementation of mandatory employer-paid contributions] was suggested." That factual finding is clearly erroneous.

Plaintiffs point out that the money raised by the elimination of the employees' rights to withdraw their pension fund contributions could have been raised by several other methods.[4] They argue that "[t]he amortization period, extended 6 years as part of the funding package, could have been extended another few years to realize a .2% contribution rate savings; the 2% cap on the post-retirement increases could have been 1.8% or 1.9% to realize the same savings; the post retirement increases, already deferred for 3 years after retirement, could have been

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[4]The removal of the employees' right to withdraw their pension fund contributions raised .2% of the total 4.2% increase in the contribution rate needed to fund the post-retirement benefits increase.

the Nevada Legislature that the elimination of the right to withdraw pension fund contributions was not necessary to fund the increase in post-retirement benefits.

[9] Nevada should not have interfered with the refund right of public employees when it was looking for ways to fund an increase in post-retirement benefits. States are not free to consider substantial contractual impairments on a par with other policy alternatives. *Trust Co.*, 431 U.S. at 30-31. In this case, the State has not met its burden of proving that the impairment of the public employees' pension rights was necessary to achieve an important public purpose. *Id.* at 31. We hold that the Nevada legislature unconstitutionally impaired the State's contractual obligations.

IV

Plaintiffs argue that the district court should have decided their pendent

state claims under Nev. Rev. Stat. §§ 284.175, 284.175, 284.160 and 284.180. We review a district court's decision not to exercise pendent jurisdiction for an abuse of discretion. *Securities Investor Protection Corp. v. Vigman*, 764 F.2d 1309, 1318 (9th Cir. 1985). The district court declined to exercise pendent jurisdiction in this case because Nevada courts had not yet fleshed out the meaning of the statutes which plaintiffs asked it to apply.

The trial court did not abuse its discretion. It did not have to examine the state statutes because Nevada "courts ha[d] not interpreted [the statutes] to any significant degree." *Fossberg v. Pacific Northwest Bell Telephone Co.*, 840 F.2d 1409, 1421 (9th Cir. 1988).

V

We reverse the district court's holdings that plaintiffs' claims are barred by res judicata, and that the elimination of

the right of non-vested public employees to withdraw pension plan contributions did not violate the contract clause. However, we affirm the trial court's decision not to exercise pendent jurisdiction. The State shall bear plaintiff's costs for this appeal.

REVERSED IN PART AND AFFIRMED IN PART

APPENDIX C

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF NEVADA

STATE OF NEVADA EMPLOYEES ASSOCIATION, et al.,

Plaintiffs,

vs.

CASE NO. CVN-86-138-BRT

WILBUR K. KEATING, et al.,

Defendants.

_____/

MEMORANDUM OPINION

This is an action for: Injunctive, declaratory and incidental relief arising under Article 1, Section 10 of the United States Constitution; the due process clause and the equal protection clause of

the Fourteenth Amendment to the United States Constitution: Title 42, United States Code, Section 1983; Article 15, Section 15 of the Nevada Constitution requiring a merit system of employment in the executive branch of State government and Nevada Revised Statutes 284.175 and related statutes requiring a uniform pay plan.

Plaintiff's primary contention is that the mandatory conversion from the joint contribution system to the employer-paid system of contributions to the Nevada Public Employees Retirement fund unconstitutionally impairs the obligation of contract. There is a subordinate claim that the State has established two pay scales for the same work in violation of the State merit system and requirement of a uniform pay plan.

Plaintiff State of Nevada Employees Association, Inc. (SNEA), is a nonstock,

nonprofit, cooperative corporation duly incorporated and existing under and by virtue of the laws of the State of Nevada. The regular membership of SNEA is restricted to and consists exclusively of employees of the State of Nevada.

The objectives and purposes of SNEA, as expressed in its Articles of Incorporation and Constitution are, among other things, "To foster acquaintanceship, cooperation, efficiency and harmony among State employees and to develop a fuller knowledge among them of the State's organization, functions and activities; to encourage and preserve a true merit system in State government; to promote the welfare of State employees in all ways compatible with the public interest, including the support of legislation deemed beneficial and resistance to legislation deemed detrimental to their interests; to encourage the maintenance of high stan-

dards of employee-conduct in governmental affairs; to advocate and defend a just and efficacious administration of laws; to aid in the improvement of government and in the development of the State's resources, and the advancement of the State's economy; to inspire and maintain in the hearts of its members a constant dedication to the principles of constitutional democracy as exemplified in our American form of government; and in all ways to render the most effective service to the people of the United States of America and of the State of Nevada."

SNEA has been officially recognized by the Senate and Assembly of the State of Nevada, by reason of the provisions of Assembly Concurrent Resolution No. 29, adopted by said Senate and Assembly at its Fifty-Fifth Session:

> WHEREAS, A substantial number of State employees are members of the Nevada State Employees' Association; and

WHEREAS, The Nevada State Employees' association should be recognized as representative of its members for purposes of preserving and advancing their interests as State employees; now, therefore, be it

RESOLVED BY THE ASSEMBLY OF THE STATE OF NEVADA, THE SENATE CONCURRING, That the legislature of the State of Nevada expresses its sense that the personnel division of the department of administration should recognize the Nevada State Employees' Association as representative of its members for discussion of conditions of employment, hours and wages, while at the same time preserving the right of State employees who are not members of such association to speak for themselves.

The regular membership of SNEA currently numbers approximately 4,300. SNEA is suing herein on its own behalf and in its representative capacity for all members of SNEA who are situated and affected in the same way as alleged by the remaining plaintiffs herein. All named individual plaintiffs are or at all times material herein were State employees and members of and required to participate in PERS; and are or were members of plaintiff SNEA.

The individual plaintiffs are all residents of the State of Nevada.

Defendant Wilbur K. Keating is the Executive Officer of Public Employees Retirement System of the State of Nevada (PEPS); is a resident of the State of Nevada; is charged by law with the responsibility of administering PERS; and is being sued herein in both his official and individual capacities.

Tom Wiesner, Peggy Glover and Wilson McGowan are succeeded in their official capacities by O.C. Lee, John Caserta and Marvin Leavitt who are hereby substituted and sued in their official capacities. Tom Wiesner, Peggy Glover and Wilson McGowan remain as defendants in their individual capacities.

Defendant George Murphy is the Director of the Department of Personnel of the State of Nevada; is a resident of the State of Nevada; is charged by law with

supervision of all administrative and technical activities of the department, including but not limited to prescribing regulations for a uniform pay plan and certification of the payroll; and is being sued herein in both his official and individual capacities.

George Murphy is succeeded in his official capacity by Glenn Rock who is hereby substituted and sued in his official capacity. George Murphy remains as a defendant in his individual capacity.

Defendant Darrell Daines is the State Controller of the State of Nevada; is a resident of the State of Nevada; is charged by law with the drawing of warrants against the State treasury for the payment of State employee salaries; and is being sued herein in both his official and individual capacities.

Defendant Patricia Cafferata is the State Treasurer of the State of Nevada; is

a resident of the State of Nevada; is charged by law with the disbursement of public money upon warrants drawn upon the treasury; and is being sued herein in both her official and individual capacities.

Patricia Cafferata is succeeded in her official capacity by Ken Santor who is hereby substituted and sued in his official capacity. Patricia Cafferata remains as a defendant in her individual capacity.

Plaintiffs Steiner, Palczewski and Dudley are regular State employees (non-police and fire) who were hired prior to July 1, 1985. Steiner and Palczewski are paid through the University of Nevada System payroll office. All other individually named plaintiffs are or were paid through the State of Nevada central payroll system.

In 1983, the Nevada legislature amended NRS 286.421.

At the time of filing the complaint, plaintiff Benzler was a police or fire State employee who was hired prior to July 1, 1983.

At the time of filing the complaint, plaintiff Reed was a regular State employee (non-police and fire) who was hired on or after July 1, 1985.

Plaintiff Riolo is a police and fire State employee who was hired on or after July 1, 1983.

Plaintiff Brown is a former regular (non-police and fire) State employee who resigned from State employment on December 31, 1985, and subsequently sought a refund of her employee contributions from PERS.

Plaintiff Drew is a former police or fire State employee who resigned from State employment. At the time of his resignation, Drew had accumulated certain hours of annual leave and compensatory time, for which payment of $336.25 was

made at the reduced rate. In addition to the original payment, Drew was paid retroactive overtime at the unreduced joint contribution rate by a supplemental warrant dated December 28, 1984 in the amount of $35.50.

Since the retirement system's inception, PERS has utilized a method of joint contribution to the system whereby the employee's share is deducted from his gross pay and the employer equally matches that amount, the total contribution then being forwarded to PERS. This is referred to as the joint contribution plan, as established in NRS 286.410, 286.450.

In 1975, another method of contribution was approved by the Nevada legislature and added to the Nevada Revised Statutes. This new method provides that a public employer may elect to pay the entire retirement contribution; however, if this scheme is adopted it must be in leu

of an equivalent salary increase or by way of a salary reduction to the employee; a record of the contribution is not made in an employee's account, and no portion of the contribution is available to the employee for withdrawal or refund.

Under the system described above, if an employee leaves the system before the 10-year vesting period, he has no right to recover the contributions made under employer-paid and receives no retirement benefit for his money contributed under employer-paid. Under employer-paid, an employee remains entitled to withdraw contributions previously made under the joint contribution plan. All service credit earned under employer-paid or under the joint contribution plan is cancelled in the event of such withdrawal of contributions.

In 1983, at the behest of PERS, the Nevada legislature amended NRS 286.421 to

make employer-paid mandatory beginning July 1, 1985 for all (a) employees hired after July 1, 1985; (b) employees vested as of July 1, 1985; and (c) employees later vesting, on date of vesting. Employer-paid was also made mandatory beginning July 1, 1983 for certain enumerated police and fire State employees without regard to vesting.

At the same time as the 1983 amendments making employer-paid retirement mandatory for the State employees, several other actions were taken by PERS and the Nevada legislature. A system of post-retirement benefit increases was enacted, NRS 286.5756; a system of contribution rate increases was enacted, NRS 286.465; and a "fail-safe" provision was enacted, NRS 286.576, providing that the post-retirement increase would cease if the contribution rates did not increase enough to pay for them.

Additionally, the legislation effected a roll-back of the amortization period on unfunded liability. At that time the system was 6 years into a 40-year amortization period and the statute simply extended the period to start a new 40-year amortization period beginning in 1984.

The stated purpose for these three actions--extending the amortization period 6 years, incrementally increasing the contribution rate, and mandatorily converting all remaining members of the system to employer-paid--was to finance post-retirement benefit increase.

The PERS actuary in 1982 estimated that if all members were under employer-paid, a .2% reduction in actuarially determined contribution rate for regular members would be realized. At the time of the 1983 legislation referred to herein, PERS had approximately 40,000 active members of which approximately 15,000 were

not under employer-paid. Of that 15,000, approximately 10,000 were State employees. Pursuant to the 1983 legislation referred to, the contribution rate has increased by 1% yearly, beginning July 1, 1985, and continuing to the present, for a total increase of 3% since July 1, 1985.

The obligations and benefits of public employment and retirement contracts are determined by the law of the State where the contract was entered into. *Ogden v. Saunders*, 25 U.S. 2112 (1827). In Nevada it is settled that the rights and obligations are contractual in character. *State of Nev. Emp. Assoc. v. State of Nevada*, 102 Nev. 287, 720 P.2d 697 (1986); *State of Nevada Employees Assoc. v. State Dept. of Prisons*, 102 Nev. 356, 724 P.2d 732; *Public Employment Retirement Board v. Washoe County*, 96 Nev. 718, 615 P.2d 972 (1980); *Allen v. State Public Employees Retirement Board*, 100 Nev. 130,

676 P.2d 792 (1984). The contracts are, however, subject to reasonable modification. They are not immutable. The Supreme Court of Nevada so declared in the *Washoe County* case, *supra*, and wrote:

> The limited vesting theory is premised on the principle that a pension is an element of compensation and thus part of the employment contract. *Betts*, 582 P.2d at 617. A pension right may not be destroyed without impairing the contractual obligation of the public employer. However, prior to absolute vesting, pension rights are subject to reasonable modification in order to keep the system flexible to meet changing conditions, and to maintain the actuarial soundness of the system. Id; *Brazelton*, 607 P.2d at 518; *Allen v. City of Long Beach*, 45 Cal.2d 128; 287 P.2d 765 (1955). To be sustained as reasonable, the modification must bear some material relationship to the purpose of the pension system and its successful operation; and any disadvantage to employees must be accompanied by comparable new advantages. *Singer*, 607 P.2d at 475-476.
>
> In this case, the employee-respondents were deprived of the right to become eligible for early retirement. The district court, applying the limited

> vesting theory, concluded that the legislature acted unreasonably and unnecessarily, because there was no evidence that the change was essential to maintain the system's integrity or flexibility. See *Singer*, 607 P.2d at 476; *Glaeser v. City of Berkeley*, 148 Cal.App.2d 614, 307 P.2d 61 (1957). But cf. *Eisenberger v. Police Pension Com'n of Harrisburg*, 400 Pa. 418, 162 A.2d 347 (1960) (court assumed an increase in retirement age enhanced actuarial soundness). In addition, the fact that the affected employees would no longer be required to pay the extra 0.5 percent is not comparable to the disadvantage of a postponed retirement (emphasis added).

So, as we analyze the problems, we are faced with three issues: (1) the possibility of claim preclusion, (2) whether the Nevada Supreme Court's characterization of the conditions or circumstances authorizing modification of a public employees' retirement system comports with the "contract clause" (Article I § 10) of the United States Constitution and (3) whether the 1983 amendments to the Nevada

retirement system unconstitutionally impair the obligation of contract.

CLAIM PRECLUSION

The State of Nevada Employees Association, Inc., our primary plaintiff, has already instituted one action involving the 1983 legislative amendments to the PERS. See *State v. State of Nevada Employees Assoc., supra*. That action involved an interpretation of the 1983 amendments to determine the employer's correct rate of contribution. Plaintiff attached the transcript of the proceedings before the Supreme Court of Nevada which demonstrates that the justices were primarily interested in the provision of the 1983 legislation which eliminated the privilege of withdrawing the "employees contribution" to the retirement fund on termination prior to ten years. The attorney for plaintiff pointed out: "that was not the issue at trial, the issue at

trial was that the fact is the police and fire employees were mandatorily placed under this employer-paid system in July of 1983. At that time they had a lot of complaints about it but the complaint that we chose to pursue to that time was . . . that it wasn't being implemented according to law."

The legislative hearings on the 1983 amendments are in evidence. SNEA participated before both the Senate Committee and the Assembly Committee and elected then to protest only the provision eliminating the privilege of an employee to recover any portion of his contribution to the retirement fund.

Thus it is crystal clear that SNEA was aware of the issues which it now wishes this Court to address and in the earlier lawsuit chose not to include those claims for relief but deliberately elected implicitly to acknowledge the validity of

the legislation and press, successfully, for an interpretation of it which was beneficial to the employees.

It is an admitted fact that the individual plaintiffs are, or were before termination, members of SNEA and in privity with it. Thus the plaintiffs are estopped to seek to prevail on this Court to invalidate the 1983 amendments.

A precedent quite closely in point is *Vandenplas v. City of Muskego*, 753 F.2d 555 (7th Cir. 1985):

> A state court judgment must be given the same **res judicata** effect in federal court that it would be given in the courts of the rendering state. *Migra v. Warren City School District Board of Education*, ___U.S. ___, 104 S.Ct. 892, 79 L. Ed.2d 56 (1984); *Mandario v. Pollard*, 718 F.2d 845, 848 (7th Cir. 1983), __, 105 S.Ct. 116, 83 L. Ed.2d 59 (1984); 20 U.S.C. § 1738. **But see** *Marrese v. American Academy of Orthopaedic Surgeons*, 726 F.2d 1150 (7th Cir.) (en banc) (federal courts may give greater res judicata effect to state court judgments than would courts of rendering state), **cert. granted**, ___U.S.___, 104

S.Ct. 3553, 82 L. Ed.2d 854 (1984). This rule applies to § 1983 actions with respect to the issues actually litigated, *Allen v. McCurry*, 449 U.S. 90, 101 S.Ct. 441, 66 L. Ed.2d 308 (1980), and also issues which could have been but were not litigated in the state court proceedings, *Lee v. City of Peoria*, 685 F.2d 196, 198-99 (7th Cir. 1982). *Migra v. Warren City School District Board of Education*, ___U.S.___, 104 S.Ct. 892, 79 L. Ed.2d 56 (1984). Thus our determination whether the Vandelplases' § 1983 claim is barred turns on the preclusive effect the various state court proceedings would have under the law of Wisconsin.

Wisconsin **res judicata** doctrine states that a final judgment is conclusive in all subsequent actions between the same parties as to all matters which were litigated or might have been litigated in the former proceedings. *DePratt v. West Bend Mutual Insurance Co.*, 113 Wis.2d 306, 310, 334 N.W.2d 883, 885 (1983); *Barbian v. Lindner Bros. Trucking Co.*, 106 Wis.2d 291, 316 N.W.2d 371 (1982); *Leimert v. McCann*, 79 Wis.2d 289, 255 N.W.2d 526 (1977); *Gohr v. Beranek*, 266 Wis. 605, 64 N.W.2d 246 (1954).

The Nevada Supreme Court approves the principle of the Wisconsin cases and gives

the same preclusive effect with respect to claims which might have been adjudicated in the first action. *York v. York*, 99 Nev. 491, 664 P.2d 967 (1983); *M & R Inv. Co. Inc. v. State*, ___Nev.___, 744 P.2d 531 (1987).

> It is an elementary rule of constitutional law that one may not 'retain the benefits of the act while attacking the constitutionality of one of its important conditions.' *United States v. San Francisco*, 310 U.S. 16, 29. As formulated by Mr. Justice Brandeis, concurring in *Ashwander v. Tennessee Valley Authority*, 297 U.S. 288, 348. 'The Court will not pass upon the constitutionality of a statute at the instance of one who has availed himself of its benefits.'"

Fahey v. Mallonee, 332 U.S. 245, 255 (1947).

The first basis for deciding in favor of defendants is that the plaintiffs cannot contend before this Court that any portion of the 1983 legislation is unconstitutional or invalid for the reasons hereinabove enunciated.

ARTICLE I CLAUSE 10

"No State shall . . . pass any . . . law impairing the Obligation of Contracts." This is the admonition of the Constitution of the United States.

It is suggested that in recent years there has been a revitalization of the contract clause after many years of disuse. "A Process-Oriented Approach to the Contract Clause," 89 Yale Law Journal 1623. The two recent cases are *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977) and *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234 (1978). Inasmuch as *Trust Co.* concerns a public contract while *Spannaus* analyzes the effect of legislation on a private retirement contract, it is to the former that we look for primary guidance.

Trust Co. involved legislation by the States of New York and New Jersey which repealed a statutory bond covenant in

bonds issued by the Port Authority of New York and New Jersey. The Supreme Court invalidated the legislation under the contract clause. We select pertinent quotations from the Supreme Court opinion as our guidelines in the case at bar.

1. "It is not every modification of a contractual promise that impairs the obligation of contract under federal law." p. 16.

2. "Nor was the covenant merely modified or replaced by an arguably comparable security provision." p. 19.

3. "As is customary in reviewing economic and social regulation, however, courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure." p. 22-3.

4. "The contract clause is not an absolute bar to subsequent modification of a State's own financial obligations. As with laws impairing the obligation of

private contracts, an impairment may be constitutional if it is reasonable and necessary to serve an important public purpose." p. 25.

5. "The extent of impairment is certainly a relevant factor in determining its reasonableness." p. 27.

6. "No one has suggested here that the States acted for the purpose of benefiting the bondholders." p. 28.

7. "We can only sustain the repeal of the 1962 covenant if that impairment was both reasonable and necessary to serve the admittedly important purposes claimed by the State." p. 29.

8. "Similarly, a State is not free to impose a drastic impairment when an evident and more moderate course would serve its purposes equally well." p. 31.

9. "And we cannot conclude that the repeal was reasonable in light of changed circumstances." p. 32.

A fair synthesis of action of the decision is: a public employment contract may be modified by the State legislature if the modification is reasonable and necessary to serve a public purpose taking into consideration changed circumstances, whether comparable benefits are provided for benefits repealed, the weight and significance of the contractual impairment, the existence of a purpose to benefit the employees, and the availability of a reasonable alternative course. Deference should be given to the legislative judgment.

The Nevada modification rule established by the Supreme Court in the *Washoe County* case, *supra*, seems to us to be reasonably consistent with the requirements articulated by the United States Supreme Court in the *Trust Co.* case. The *Washoe County* case held the amendment of PERS to be an unconstitutional impairment of con-

tract because there was not evidence that the change was necessary to maintain the integrity of the system and there were no advantages to offset the disadvantages of the amendment.

The Nevada Supreme Court relied heavily on *Singer v. City of Topeka*, 607 P.2d 467 (Kan. 1980) and thus implicitly adopted the principle:

> We do not adopt the balancing test of *Abbott*; instead, we hold that, insofar as the rights of active employees in and to pension plans are concerned, the reasonableness of legislative changes is to be measured by the advantage or disadvantage to the affected employees as a group or groups; validity of change is not dependent upon the effect upon each employee.

THE 1983 LEGISLATIVE AMENDMENTS DO NOT UNCONSTITUTIONALLY IMPAIR THE OBLIGATION OF CONTRACTS

Viewing the 1983 amendments as a whole and their impact upon all public employees as a group, it is evident that the legislation does not unconstitutionally impair an employee's contractual rights

to retirement benefits. The public purpose of the legislation is laudable, that is, to establish a system of regular post-retirement benefit increases to meet increases in the cost of living. After thorough study, adjustments were made to accomplish this which resulted in higher take-home pay for the employee and an actuarially sound retirement system. The only disadvantage was the elimination of the privilege of an employee to recover a portion of the money contributed to the State retirement fund in the event the employment terminated prior to vesting. The money of which an employee was thus deprived was not his money. Opinions of the Attorney General of the State of Nevada No. 307, September 6, 1957. It was money belonging to the State of Nevada under the terms of the employment contract with the public employee. *Atkinson v. Wittler*, 647 P.2d 72 (Wyo. 1982). Thus,

although under the joint contribution system early termination included a contractual benefit of partial reimbursement, the elimination of that benefit has less significant impact than if a due process violation were also present. The contract impairment is less extensive. For the legislature to accomplish its purposes of funding post-retirement increases without increasing the cost of the retirement system, the elimination of the reimbursement feature was reasonably necessary. The legislative history and actuarial studies in evidence establish that it was thus made to appear to the legislature. No reasonable alternative resulting in less impairment was suggested. The State acted expressly for the benefit of the employees (not the case in *Trust Co., supra*). It also should be emphasized that at the time of the 1983 amendments almost two-thirds of the numbers of the state retirement

system were already under the employer-paid method of contribution. The impact of the amendments on the whole body of covered employees was less significant. The Court should defer to the legislative judgment.

STATE MERIT SYSTEM

The contention that the legislation conflicts with the state merit system is rejected for two reasons: (1) it is subject to the claim preclusion effect of the earlier litigation, and (2) it rests strictly upon a difficult interpretation of the state statutes with respect to which the Nevada Supreme Court has given no guidance, it is not within the subject matter jurisdiction of this Court, and this Court declines to entertain it because it is an inappropriate claim for consideration within its pendent jurisdiction.

The foregoing shall constitute the Court's findings of fact and conclusions of law.

Accordingly,

IT HEREBY IS ORDERED that judgment shall be entered in favor of defendants and against the plaintiffs.

DATED September 16, 1988.

UNITED STATES DISTRICT JUDGE

Supreme Court, U.S.
FILED
NOV 13 1990
JOSEPH F. SPANIOL, JR.
CLERK

(2)

No. 90-630

In The

Supreme Court of the United States

October Term, 1990

WILBUR K. KEATING, Executive Officer of the Public Employees' Retirement System, et al.,

Petitioners,

vs.

STATE OF NEVADA EMPLOYEES ASSOC., INC., (SNEA), a Nevada corporation, as representative of its members; ELLEN STEINER, et al.,

Respondents.

Petition For Writ Of Certiorari To The United States Court of Appeals For The Ninth Circuit

RESPONDENTS' BRIEF IN OPPOSITION

NORAH ANN MCCOY
(Counsel of Record)
State of Nevada Employees Association, Inc.
P.O. Box 1016
Carson City, Nevada 89702
Telephone: (702) 882-3910

Counsel for Respondents

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

I. Can a state strip all its employees of the statutorily guaranteed right to a refund of retirement contributions by transferring the employees' contributions to an account declared unreachable?

II. Doesn't an unrepealed, 40 year-old statutory guarantee of a return of retirement contributions constitute a contract between a state retirement system and its members?

III. Is a state retirement system obligated to deal fairly and equitably with all of its members, who are required to participate in the system?

LIST OF PARTIES

Respondents refer to petitioners' list of parties with the added notation that the State of Nevada Employees Association, Inc., is a non-stock, non-profit corporation with no parent companies or subsidiaries.

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RESPONDENTS' BRIEF IN OPPOSITION

Respondents oppose the petition for writ of certiorari as follows.

STATEMENT OF THE CASE

All full-time state employees – about 10,000 in number – are required to participate in Nevada's Public Employees' Retirement System (PERS). They are not covered by federal Social Security.

Until 1985, state employees were under the joint contribution plan, whereby the employee's share was deducted from his gross pay and matched by his state employer. At all times Nevada law guaranteed each such employee the return of at least the total employee contributions made and credited to his individual account. Nev. Rev. Stat. 286.410, Appendix App. 1. Thus, if an employee left state service, he could obtain a refund of his contributions. With 10 years required to vest a retirement benefit, a contribution refund was the only money 93% of state employees ever received from the retirement system.

Beginning in 1985, state employees were legislatively required to participate in the "employer-paid" contribution plan. The employees had to take a pay cut equal to their share of the contribution; then the employer "paid" the entire contribution. While Nev. Rev. Stat. 286.410 guaranteeing the return of at least the employee contributions was not amended or repealed, it was circumvented by a provision in the employer-paid law prohibiting deposit of these funds in the employee's individual account and declaring them unavailable for refund. Nev. Rev. Stat. 286.421(4), reprinted in full in the petition. Worse yet, the employee's lost pay within the first 10 years of employment – typically over $20,000 – was used by the retirement system to help pay for post-retirement benefit increases for retirees.

On appeal, the United States Court of Appeals for the Ninth Circuit determined that the employees have contractual rights in their pension plan, that the modification complained of constituted a contractual impairment, and that the impairment was neither reasonable nor necessary. In doing so, the court applied settled legal principles to all the facts of record, and the result was both sensible and fair.

REASONS FOR DENYING THE WRIT

1. The issues in this case are not sufficiently important to warrant this Court's attention.

This dispute involves the 10,000 or so state employee members of Nevada's Public Employees' Retirement System. Even though the remaining 35,000 public employee members of PERS are also covered by "employer-paid," virtually all of those employees voluntarily went under the system through their collective bargaining process, receiving unknown concessions or other benefits in return.

State employees, who do not have collective bargaining, were mandated into the plan and received no advantage comparable to the disadvantage of the loss of a refund right.

Furthermore, not even any other state has the same plan. The employees' actuarial expert testified at trial:

> MS. MCCOY: Tell us, if you can, Mr. Hendrickson, how common is a non-refundability feature in a public retirement system? In other words, is it usual or unusual for an

employee to be able to withdraw his contributions or not to be able to withdraw his contributions when he leaves the system?

A. It is very rare that any public system would provide that if an employee contributed to it that that employee would not recover his or her contributions upon termination of employment if the employee chose to recover.

Q. On what do you base that conclusion?

A. Several points. I think the most relevant is the study conducted by the American Association of Retired Persons, AARP. * * * Their conclusions in the report were that of the 50 states 48 states refunded employer contributions, in fact, 41 refunded both the contributions and the interest. Only seven didn't refund the interest. So, 48 refunded.

The 49th state is Florida, and Florida has a pure employer-pay plan. The employees do not get any reduction [in] benefits, never have. The employer does in fact pay all the costs of the system; so, there are no employee contributions to be refunded.

The only one out of the 50 studied that does not refund employee contributions is the State of Nevada according to that study. That supports my personal experience. I am not aware of any public system except Nevada that doesn't refund it.

Trial Transcript, pp. 272-73.

This testimony was corroborated by the testimony of the PERS actuary:

MS. MCCOY: And how many other systems are you familiar with that have the same type of provision that an employee takes a cut in pay to

> go under an employer-paid plan, the money is not put in his individual retirement account and it is not refundable to the employee? How many other systems are you familiar with that have the same provision?
>
> MR. MACKIN: The Nevada system has provisions that are unique to Nevada. I do not know of any system that has precisely the same provisions.

Trial Transcript, p. 427.

This Court has long considered it important to be " . . . consistent in not granting the writ of certiorari except in cases involving principles the settlement of which is of importance to the public as distinguished from that of the parties. . . . " *Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 393 (1923), cited, *Rice v. Sioux City Memorial Park Cemetery, Inc.*, 349 U.S. 70, 79 (1955).

2. The Court of Appeals reached a fair and correct result.

Petitioners argue that the Ninth Circuit Court of Appeals should not have applied the Contract Clause of the U.S. Constitution to protect employees hired after the effective date of the retirement modification because those employees have no contract with the state. Their argument fails for two reasons.

First, in their petition for rehearing, petitioners had ample opportunity to ask the Court of Appeals to define or otherwise describe what, if any, contract with these employees the legislation impaired. This they did not do. Where issues are neither raised before nor considered by

the Court of Appeals, this Court will ordinarily not consider them. *Adickes v. Kress & Co.*, 398 U.S. 144, 147, n.2 (1970).

Second, if petitioners had sought a clarification of this issue, Judge Beezer might well have advised that: 1) All full-time state employees – past, present and future – are required to be members of PERS; 2) Nev. Rev. Stat. 286.410 has and continues to guarantee to all employee members of PERS the return of their contributions; 3) Legislatively transferring the employees' contributions to an account declared non-refundable is an impairment of the state's obligation under the contract created by Nev. Rev. Stat. 286.410; and 4) Being unreasonable and unnecessary, the impairment is unconstitutional.

The Court of Appeals' result was not only correct, it was fair. The state's mandatory employer-paid scheme creates an obvious inequity for 93% of state employees. They are required to belong to PERS; they typically do not vest a retirement benefit; yet tens of thousands of dollars of their earned pay is exacted and kept by PERS to pay for benefits accrued to former employees.

CONCLUSION

The outcome of this case is important only to the parties. The result below was correct and fair. The petition for a writ of certiorari should be denied.

Respectfully submitted,

NORAH ANN MCCOY
(Counsel of Record)
State of Nevada Employees
Assoc., Inc.
P.O. Box 1016
Carson City, Nevada 89702
Telephone: (702) 882-3910

Counsel for Respondents

APPENDIX

286.410 Amount of contribution by member of system; deduction from payroll; return of contributions; disabled members.

1. The employee contribution rate is 9 percent of compensation for police officers and firemen and 8 percent of compensation for all other members, plus in each case one-half of any increase required by NRS 286.465.

2. From each payroll during the period of his membership, the employer shall deduct the amount of the member's contributions and transmit the deduction to the board at intervals designated and upon forms prescribed by the board. The contributions must be paid on compensation earned by a member from his first day of service.

3. Any employee whose position is determined after July 1, 1971, to be eligible under the early retirement provisions for police officers and firemen shall contribute the additional contributions required of police officers and firemen from July 1, 1971, to the date of his enrollment under the police and firemen's retirement fund, if employment in this position occurred before July 1, 1971, or from date of employment in this position to the date of his enrollment under the police and firemen's retirement fund, if employment occurs later.

4. Except as provided in NRS 286.430, the system shall guarantee to each member the return of at least the total employee contributions which the member has made and which were credited to his individual account. These contributions may be returned to the member, his

estate or beneficiary or a combination thereof in monthly benefits, a lump sum refund or both.

5. Disabled members who are injured on the job and receive industrial insurance benefits for temporary total disability remain contributing members of the system for the duration of the benefits if and while the public employer continues to pay the difference between these benefits and his regular compensation. The public employer shall pay the employer contributions on these benefits.

286.430 Withdrawal of contributions.

1. Except as otherwise provided in subsection 8, a member may withdraw the employee contributions credited to his individual account if:

(a) He has terminated service for which contribution is required; or

(b) He is employed in a position for which contribution is prohibited.

2. The system shall not refund these contributions until it has received:

(a) A properly completed application for refund;

(b) A notice of termination from the member's public employer or a certification by the public employer that the member is employed in a position for which contribution is prohibited; and

(c) Except as otherwise provided in subsection 3, all contributions withheld from such member's compensation.

3. If a member submits an application for a refund of his contributions before all of his contributions which were withheld have been remitted, the system may refund the portion of his contributions which it has received.

4. If it is determined, after the system has refunded the contributions of a member, that an additional amount of less than $10 is due to him, a refund of that amount need not be paid.

5. Refunds, pursuant to this section, must be made by check mailed to the address specified by a member in his application for refund.

6. The system shall transfer all money retained pursuant to subsection 4 and the amount of any unclaimed refund checks to the public employees' retirement fund or the police and firemen's retirement fund.

7. All membership rights and active service credit in the system, including service for which the public employer paid the employee contributions, are canceled upon the withdrawal of contributions from a member's account.

8. A member who transfers to a position for which contribution is prohibited must remain in that position for at least 90 days before he is eligible to receive a refund pursuant to this section.